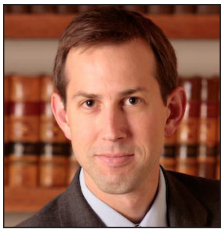


# STOP! DO NOT PASS GO, DO NOT COLLECT \$200—Primer on the Automatic Stay for Non-Bankruptcy Practitioners

by Susan Heath Sharp and Daniel R. Fogarty



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After years of legal battling, your client obtains a final judgment only to find out that the judgment debtor just filed bankruptcy. Your client turns to you for advice on what to do next. To your client's frustration, all collection efforts come to a screeching halt. Protections afforded by the automatic stay are a critical component of the Bankruptcy Code,<sup>1</sup> and there are few matters as fundamental to the bankruptcy process as the operation of the automatic stay.

The automatic stay applies equally in all chapters of bankruptcy—Chapter 7 (liquidation) and Chapters 9, 11, 12, and 13 (reorganization)—whether the bankruptcy is voluntary or involuntary. The automatic stay is intended to provide the debtor with breathing room in order to attempt a repayment or reorganization plan or simply to be relieved of “the financial pressures that drove the debtors into bankruptcy.”<sup>2</sup> The existence of the automatic stay stops collection efforts against the debtor and the debtor's property, thereby creating a more level playing field “by avoiding the piecemeal or distressed liquidation of the debtor's assets and a race to the courthouse” by one creditor to the detriment of all creditors.<sup>3</sup>

The automatic stay applies to almost any type of formal or informal action taken against the debtor and property of the debtor's bankruptcy estate. The bankruptcy estate includes virtually all property of the debtor at the time of filing and is created under § 541 of the Bankruptcy Code. The concept of property of the estate is exceedingly broad and encompasses property rights including “all legal or equitable interests of the debtor in property.”<sup>4</sup> Congress intended to bring “anything of value” that a debtor owns into the estate, including the debtor's contingent claims and causes of action even if commenced after filing the bankruptcy petition.<sup>5</sup>

It is important to note that the automatic stay is self-executing upon filing the bankruptcy petition; there is no other action that a debtor needs to take for the imposition of the stay.<sup>6</sup> The automatic stay is “ef-

fective against the world regardless of whether a party had notice of the bankruptcy filing or of the automatic stay.”<sup>7</sup> Violations of the automatic stay have serious consequences for a creditor, including the imposition of contempt sanctions for a knowing and willful violation, because the automatic stay is essentially the equivalent of a court order.

## Scope of the Automatic Stay

The automatic stay is extremely broad in scope, providing the debtor with protection from an extensive range of actions and activities. It automatically stays collection actions, foreclosures, and almost all judicial proceedings against the debtor and the debtor's property.<sup>8</sup>

The automatic stay protects the debtor and estate property, but does not protect third parties, such as corporate officers or directors, partners in the debtor's partnership, co-defendants in pending litigation, or separate legal entities. These third parties are not without protection. Most circuits recognize that a bankruptcy court possesses the statutory authority under § 105(a) to issue injunctive relief in favor of non-debtors under certain circumstances, which generally involves actions against certain co-debtors or insiders, such as guarantors, sureties, or partners, that may affect the debtor's ability to reorganize. And § 1301 of the Bankruptcy Code specifically provides a co-debtor stay in the case of “consumer debt of the debtor from any individual that is liable on such debt with the debtor.”<sup>9</sup>

Another limit to the scope of the automatic stay is for post-petition acts. Actions on a claim against a debtor that arises after the commencement of a case are not stayed, provided that any enforcement of a claim does not act against property of the bankruptcy estate.<sup>10</sup>

Even though the Bankruptcy Code's automatic stay provisions do not apply to a debtor's acts, but rather only to acts against the debtor, some case law has developed holding that the stay applies to the continuation of an appeal by the debtor in litigation

filed pre-petition against the debtor.<sup>11</sup> Appellate courts generally stay an appeal until the bankruptcy court grants stay relief.<sup>12</sup>

While § 362(b) lists 28 very specific activities that are excepted from the automatic stay, experienced bankruptcy practitioners generally seek stay relief from the bankruptcy court or proceed with extreme caution before moving forward on excepted conduct because of the risk of court sanctions for violating the automatic stay. The excepted conduct includes such activities as criminal action or proceeding against the debtor, collection of domestic support obligations from property that is not property of the estate, suspension of driver's license or professional license, and the exercise by the government of its police or regulatory powers.

### Duration of the Automatic Stay

The automatic stay does cease at some point. The automatic stay remains in effect against property of the estate until such property is no longer property of the estate.<sup>13</sup> This occurs either because the property is claimed as exempt by the debtor, sold or abandoned by the bankruptcy estate, or because a plan of reorganization has been confirmed. In the case of exempt property (e.g., retirement funds, homestead, certain personal property as determined under state law) such property remains exempt from pre-petition creditors.

The Bankruptcy Abuse Prevention and Consumer Act of 2005 modified the automatic stay in the case of individual serial bankruptcy filings so that the automatic stay will last only 30 days if a debtor had a prior bankruptcy within the year before the current filing, unless the debtor seeks to extend the stay.<sup>14</sup> In the case of a debtor who had two or more prior cases pending within a year, and such cases were dismissed during the one-year period, there is no stay in effect upon filing.<sup>15</sup> Out of the abundance of caution, one dealing with a serial filer should confirm that the stay has been terminated before taking any action.<sup>16</sup>

With respect to acts against the debtor, the automatic stay remains in effect until the case is closed or dismissed, or in the case of an individual until a discharge is granted or denied.<sup>17</sup> If a discharge is granted, the stay is replaced by the discharge injunction, which permanently stays actions on discharged debts.

### Relief From Stay

If your client is subject to the automatic stay, it cannot take any actions subject to the stay without approval from the bankruptcy court, in bankruptcy parlance referred to as relief from the automatic stay. Section 362(d) sets forth the grounds for relief from the stay, which is generally handled by filing a motion with the bankruptcy court (and payment of a filing fee). The court may either terminate, annul, modify, or condition the stay “for cause, including the lack of adequate protection of an interest in property” or grant relief from the stay against property “if the debtor does not have equity in the such property; and such property is not necessary to effective reorganization.”<sup>18</sup>

Creditors often attempt to contract for stay relief through provisions in pre-petition contracts that waive or alter the automatic stay. As a general rule, bankruptcy courts typically do not enforce such provisions because the purpose of the stay is to protect creditors as well as the debtor. Courts that have considered the waiver issue have used three basic approaches: (1) uphold the stay waiver in broad unqualified terms on the basis of freedom of contract; (2) reject the stay waiver as unenforceable per se as against public policy; and (3)

treat the waiver as a factor in deciding whether “cause” exists to lift the stay.<sup>19</sup>

### Violation of Stay

Because the stay is imposed automatically, and often without notice to the party stayed, the automatic stay may be violated by a party without realizing the stay is in effect. Generally speaking, “actions taken in violations of the automatic stay are void *ab initio* and therefore without effect,” including orders entered by state courts.<sup>20</sup>

Since a party may have knowledge of the bankruptcy but choose to ignore it or be under the mistaken belief that they may still proceed against the debtor or property of the estate, most courts will impose contempt sanctions for a knowing and willful violation.<sup>21</sup> As a general rule, punitive damages for violation of the automatic stay are appropriate only when the violator has engaged in egregious, intentional misconduct.<sup>22</sup> Once a creditor has notice of the bankruptcy case, the creditor has the “responsibility to refrain from violating the stay.”<sup>23</sup> Many courts, putting a higher burden on a creditor than merely refraining from violating the stay, “have emphasized the obligation of creditors to take affirmative action to terminate or undo any action that violates the automatic stay” and failure to do so may be considered a willful violation.<sup>24</sup>

Because of the fundamental importance of the automatic stay to the bankruptcy process, it is exceedingly broad and brings stiff penalties if violated. When dealing with its potential application, exercise caution and don't take a chance. ☉

### Endnotes

<sup>11</sup>11 U.S.C. § 101 et seq. Unless otherwise indicated, all section references herein are to the Bankruptcy Code (Title 11 of the U.S. Code).

<sup>2</sup>*In re Weidenbenner*, 521 B.R. 74, 81 (Bankr. S.D.N.Y. 2014).

<sup>3</sup>*Ford v. Loftin (In re Ford)*, 296 B.R. 537, 548 (Bankr. N.D. Ga. 2003).

<sup>4</sup>§ 541(a).

<sup>5</sup>H.R. Rep. No. 95-595, at 367 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5963, 6323.

<sup>6</sup>§ 362(a).

<sup>7</sup>*Henkel v. Frese, Hansen, Anderson, Hueston, & Whitehead, P.A., et al. (In re Newgent Golf Inc.)*, 402 B.R. 424, 433 (Bankr. M.D. Fla. 2009) (citations omitted).

<sup>8</sup>§ 362(a) provides that filing a petition operates as a stay against the following activities—

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### Editorial Policy

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- (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
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- (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
- (8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

<sup>9</sup>II U.S.C. § 1301(a).

<sup>10</sup>§ 362(a)(1).

<sup>11</sup>*See, e.g., Ass'n of St. Croix Condo. Owners v. St. Croix Hotel Corp.*, 682 F.2d 446, 449 (3d Cir. 1982).

<sup>12</sup>*See id.*

<sup>13</sup>II U.S.C. § 362(c)(1).

<sup>14</sup>§ 362(c)(3).

<sup>15</sup>§ 362(c)(4).

<sup>16</sup>§ 362(j).

<sup>17</sup>§ 362(c)(2).

<sup>18</sup>§ 362(d).

<sup>19</sup>*In re Triple A & R Capital Inv. Inc.*, 519 B.R. 581, 584 (Bankr. D.P.R. 2014), *aff'd* No. 14-1896, 2015 WL 1133190 (D.P.R. Mar. 12, 2015).

<sup>20</sup>*Newgent Golf*, 402 B.R. at 433 (citing *United States v. White*, 466 F.3d 1241, 1244 (11th Cir. 2006)).

<sup>21</sup>II U.S.C. § 362(k) provides—

(1) Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

(2) If such violation is based on an action taken by an entity in the good faith belief that subsection (h) applies to the debtor, the recovery under paragraph (1) of this subsection against such entity shall be limited to actual damages.

<sup>22</sup>*Roche v. Pep Boys Inc. (In re Roche)*, 361 B.R. 615 (Bankr. N.D. Ga. 2005).

<sup>23</sup>*In re Baird*, 319 B.R. 686, 689 (Bankr. M.D. Ala. 2004) (citing *Mitchell Const. Co. Inc. v. Smith (In re Smith)*, 180 B.R. 311, 319 (Bankr. N.D. Ga. 1995)).

<sup>24</sup>*In re Wright*, 75 B.R. 414 (M.D. Fla. 1987).

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